Summer 2018

FINANCIAL newsletter

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INSIDE THIS ISSUE

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WHAT IS YOUR BANK WORTH? NOTES ON BANK M&A TRENDS AND CONSIDERATIONS

We've come a long way from the dark days following the "Great Recession." Overall economic growth has been steady if not spectacular. Interest rates have been held at historic lows, but are finally starting to rise. Tax reform has lowered business tax rates. There is hope that the tsunami of regulation is slowing, if not receding. Based on these factors, most banks are showing improved earnings and improved prospects.

Strength in earnings and improvement (both perceived and real) in the business climate are driving higher bank valuations. Buyer proposals are stronger, especially when the acquirer can demonstrate achievable economies of scale from the acquisition. When buyers have more financial strength, seller price expectations in bank acquisition transactions move higher.

It is certain that concerns and questions remain present. Will regulatory burdens actually modulate to a more realistic and sustainable level? What will it cost to develop and implement the technology necessary to attract and keep the next generation of quality customers, while meeting the mounting challenges of cybersecurity? How will changes in demographics and use of technology affect the number, location and size of branches? What is the "right size" for a bank in this environment?

continued on pg 2

WHAT IS YOUR BANK WORTH? NOTES ON BANK M&A TRENDS AND CONSIDERATIONS

continued from pg 1

Despite all of the complex factors and questions, recent reports show steady upward movement in acquisition prices. Nationally, according to SNL Financial and Piper Jaffray, the ratio of deal value to tangible book value ("TBV") is exceeding 1.75 to 1 in 2018, as compared to 1.6 to 1 in 2017 and 1.25 to 1 in 2013. Most transactions nationally involve banks under $500 million and principally in the Midwest region. The market favors the achievement of operating scale, at least up to a point. The highest multiples are being paid for banks in the $2.5 billion and above asset class, where price to TBV ratios run at an average close to 2.0 to 1. Banks below $500 million in assets are drawing prices at lower levels – around 1.5 to 1 – demonstrating the difference size makes for shareholder value.

In Minnesota, since 2014, announced deals ratios have ranged between 1.25 to 1 and 2.0 to 1, and recent deals have been closer to the higher end of the range. Overall the "tailwinds" of lower taxes, higher interest rates and steady to strong economic growth are anticipated to outweigh the "headwinds" of regulatory burden, technology costs and increased cost of funds.

Many banking organizations are reportedly also exploring growth through non-bank acquisitions, including insurance, broker-dealer, wealth management, trust services and specialty lending. Growth potential based on non-bank revenue streams that do not require substantial balance sheet support will also enhance valuation. Finally, the market is beginning to see impacts from the "FinTech" entrepreneurs who use increasingly sophisticated technology platforms to build new financial service revenue sources such as peer lending, money management services, investment advisory tools and enhanced cybersecurity systems, including utilization of block chain technology.

Overall, buyers will likely continue to seek optimal scale and will be willing to pay premiums where they see bank business portfolios which are financially, geographically and demographically well rounded. For sellers who hold desirable market niches, unique and growing revenue streams (from both traditional banking and non-banking sources) and solid track records, values will continue to strengthen. ■

Stein and Moore Join Gislason & Hunter LLP

As of May 1, 2018, Peter Stein and Ralph Moore are associating with Gislason & Hunter LLP and become active members of the financial and banking practice group.

As they have done through Stein & Moore, P.A. for the past 40 years, Peter and Ralph will continue to represent community banks, large financial institutions and other lenders in loan enforcement and litigation, foreclosures, workouts, creditor's rights in bankruptcy, chapter 11 bankruptcies, SBA lending, loan documentation, loan product development, UCC matters, bank operations issues and lender liability defense.

For contact and biography information on Peter and Ralph please go to the Gislason & Hunter LLP web site
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WHAT LENDERS SHOULD KNOW ABOUT CONTRACTS FOR DEED

By Dean Zimmerli
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Contracts for deed, also known as installment land contracts, have long been used among property owners and buyers as an alternative to a traditional mortgage loan as a means of financing land purchases. Even though contracts for deed are not necessarily as prevalent as they once were, it is not uncommon for borrowers to be involved in these land transactions. Lenders whose borrowers are purchasing or selling land pursuant to a contract for deed should understand what they are, generally how they work, and how the lender can rely on those arrangements as potential security for a loan.

What are Contracts for Deed, and How do they Work?

A contract for deed is a unique type of a real estate purchase agreement. In the typical contract for deed, the owner of land—known as the "vendor"—will agree to sell land to the buyer—the "vendee"—for a set price, usually to be paid out in a number of installments over the course several years or even decades. This stands in contrast to a typical real estate purchase agreement that normally calls for single payment of the full purchase price a few weeks or months after the agreement is signed. The owner of the land retains legal title to the land until all of the payments have

been made. The buyer has an equitable "vendee's interest" under the contract for deed. Once the payments are complete, the owner of the property delivers a deed to the buyer.

In a way, contracts for deed are quite similar to a mortgage loan for the buyer—the buyer is typically able to occupy the property immediately even though the buyer cannot afford to pay the entire purchase price up front. But instead of making mortgage payments to a lender, the buyer makes periodic payments to the seller. For this reason, buyers who cannot qualify for a mortgage loan from a lending institution may seek to purchase real estate pursuant to a contract for deed.

However, missed payments under a contract for deed are treated much differently than under a mortgage loan. In the context of a contract for deed, when a buyer defaults by missing a payment, a seller can immediately declare the contract cancelled by providing written notice to the buyer, along with a statutory 60-day opportunity to cure the default. Unless the buyer cures the default, the contract will terminate, the buyer will lose the right to occupy the property, all interest in the property will revert back to the seller, and the seller can seek an immediate eviction. In addition, the seller is able to keep all payments made up until that point, and is typically entitled to all improvements the buyer may have made to the property. This differs considerably from the mortgage foreclosure process, where months or years can go by before the mortgagor no longer has a right to retain the property and where the mortgagor is entitled to any surplus equity beyond the outstanding loan amount after a foreclosure sale.

Lending to a Contract for Deed Purchaser

If a potential borrower is purchasing land pursuant to a contract for deed and has significant "equity" under the contract, how can the lender rely on the land as potential collateral for a loan? For example, say a borrower is in the process of purchasing farmland on a contract for deed that he entered into several years ago; the land is worth $1,000,000 today, and the borrower only has $100,000 in payments left to make. In this example, the borrower has $900,000 in "equity" in the land.

The first matter to keep in mind is that the buyer's interest in the contract for deed is treated as real property under the law. Accordingly, a contract for deed buyer can mortgage his interest in the property being purchased, and the process would be similar to that of any other mortgage. However, lenders should approach this route with some caution. A buyer on a contract for deed can only mortgage the rights he has in the land, and the lender will be able to obtain no more than that. So, if the contract for deed buyer misses a payment and the contract for deed is cancelled through the process described above, the buyer's rights will be extinguished, along with any mortgage granted by the buyer.

Taking a mortgage on contract for deed property is somewhat like taking a second mortgage on a property; the senior position—the contract for deed seller—can potentially wipe out the more junior position of the mortgagor. But in a contract for deed situation, the risk is somewhat greater. If a senior mortgage is foreclosed, Minnesota law provides specific rights in for a junior mortgagee to redeem its interest by paying off the senior mortgage. But while a mortgagee of contract for deed property is generally entitled to notice before the contract for deed is cancelled, the statute does not specify that a "junior" mortgagee is necessarily entitled to pay off the contract for deed or take other steps to protect its position; though, a better reading of the statute would be that the mortgagee has such a right. Thus, there is a significant risk that a mortgage on contract for deed property could be wiped out completely through a cancelation, with limited recourse.

continued on pg 6

WHAT LENDERS SHOULD KNOW ABOUT CONTRACTS FOR DEED

continued from pg 5

One solution for lenders is for the contract for deed seller to subordinate their interest to the lenders' mortgage. Through a subordination, the mortgage would essentially be treated as superior to that of the contract for deed; if the contract for deed was cancelled and the buyer's interest extinguished, the mortgage would still remain on the real estate, and the lender could still foreclose. But of course, this requires the cooperation of the seller, which might not always be easy to come by.

Contract for deeds raise unique questions about priority and what occurs during a default, so lenders should proceed carefully before relying on contract for deed property as security for a loan.

Lending to a Contract for Deed Seller

Even though the buyer's rights under a contract for deed constitute real property under Minnesota law, the contract for deed seller still retains legal ownership of the real estate as well. Thus, a lender could obtain a mortgage on the seller's legal title to property being sold via a contract for deed.

But if the lender intends on relying on the stream of payments owed under contract for deed as security, the lender should obtain a security interest in the seller's accounts. Under the Uniform Commercial Code governing security interests, the right to receive payments under a contract for deed is treated as an account, the same as receivables that might be owed to a business. And obtaining that security interest is the same as for most other personal property: the lender should obtain a security agreement granting a security interest in the seller's accounts, and then file a UCC financing statement to perfect the security interest. If it comes time to collect, the lender can notify the contract for deed buyer and require that payments be made directly to the lender.

Summary

Rights under a contract for deed might make up an important mix of a borrower's assets or potential collateral. Knowing the basics of how a contract for deed operates can allow a lender to evaluate and manage potential risks when lending to a person buying or selling property under a contract for deed.

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UCC FINANCING STATEMENTS:
THE IMPORTANCE OF THE DEBTOR'S NAME

Many in the banking industry are aware that Article 9 of the Uniform Commercial Code (as enacted by state legislatures) is the law that provides a mechanism by which a creditor can obtain a security interest in its debtor's collateral. Central Article 9 provisions deal with "attachment" and "perfection" of a security interest. Article 9 provides that a creditor's security interest becomes enforceable against the debtor (i.e., the security interest "attaches" to the debtor's collateral) when value has been given to the debtor, the debtor has rights in the collateral, and the debtor has authenticated a security agreement that describes the collateral. Aside from a few exceptions, a security interest is "perfected," and thus provides notice to other parties of the creditor's security interest, when a financing statement (form UCC-1) is properly completed and filed. This article focuses on a creditor's perfection of a security interest by filing a financing statement.

A financing statement is complete if it provides the name of the debtor, provides the name of the secured party or a representative of the secured party, and indicates the collateral covered by the financing statement. Generally speaking, when these requirements are substantially satisfied, the financing statement is effective even if it contains minor errors or omissions, unless the errors or omissions make the financing statement "seriously misleading." A financing statement that fails to provide the name of the debtor with 100% accuracy is seriously misleading per se, unless a search for the filing statement under the debtor's correct name—using the filing office's standard search logic—would disclose the financing statement. In the case of individual debtors, the debtor's name is correct if it matches that on the debtor's driver's license.

continued on pg 8

UCC FINANCING STATEMENTS: THE IMPORTANCE OF THE DEBTOR'S NAME

continued from pg 7

Notwithstanding the apparent clarity of the above rules, mistakes are sometimes made when completing and filing financing statements. One such mistake came to light in the recent bankruptcy case captioned In re Pierce, 581 B.R. 912 (Bankr. S.D. Ga. 2018). There, Kenneth R. Pierce (the debtor) borrowed $18,000.00 from Farm Bureau Bank to purchase a fertilizer spreader, and the parties entered into a security agreement which granted Farm Bureau a security interest in the spreader. Farm Bureau then filed a financing statement that identified the debtor as "Kenneth Pierce." At the time of the financing statement's filing and throughout the case, the debtor's driver's license identified him as "Kenneth Ray Pierce." However, the debtor signed his driver's license as "Kenneth Pierce" and not "Kenneth Ray Pierce."

Pierce opposed Farm Bureau's secured claim filed in the bankruptcy proceeding, arguing that because Farm Bureau's financing statement identified him as "Kenneth Pierce" and not "Kenneth Ray Pierce," the financing statement was ineffective. Farm Bureau responded that identifying the debtor as "Kenneth Pierce" substantially satisfied the UCC's requirements and merely constituted a minor error or omission that could be forgiven. Farm Bureau also argued that because the debtor signed his driver's license as "Kenneth Pierce," the financing statement did in fact include Pierce's name as indicated on his driver's license.

The Bankruptcy Court rejected Farm Bureau's argument and held that the signed name on a debtor's driver's license is not the name on which creditors should rely when filing a financing statement; instead, the printed name on the driver's license is what should be reflected in the financing statement. The court found that allowing either a signed or a printed name to be the basis for a financing statement would circumvent the UCC's goals of certainty, predictability, and simplicity, which are better accomplished by relying on a printed name. The court also found that the omission of the debtor's middle name was seriously misleading because the financing statement did not reflect Pierce's exact, full name. The court bolstered this conclusion by finding that a UCC search for "Kenneth Ray Pierce" did not reveal Farm Bureau's financing statement, meaning that creditors could not find Farm Bureau's financing statement by searching under the debtor's exact, full name.

In re Pierce stands as a warning to secured creditors that regularly complete and file financing statements. Such creditors must not only be aware of the rules applicable to financing statements, but they must also be on alert for potential nuances that can complicate an otherwise straightforward process, especially when a seemingly small error or omission can suddenly transform a secured claim into an unsecured claim. ■

SEXUAL HARASSMENT POLICIES

By Brittany R. King-Asamoa
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A sexual harassment policy is one policy every employer should have. This statement is probably not news to any employer reading this article today, given the highly-publicized terminations of Matt Lauer, Charlie Rose, and the like. But, what employers may not know is that sexual harassment policies can substantially minimize an employer's liability by (1) defining sexual harassment for employees; (2) informing employees that sexual harassment is prohibited; and (3) establishing steps an employee may take to report sexual harassment. Employers utilizing such a policy may qualify for an affirmative defense (depending on the circumstances) that may eliminate or limit their damages.

Components of a Sexual Harassment Policy

The next logical question is: What should I include in a sexual harassment policy? Three elements of the policy were outlined above—(1) a definition of sexual harassment; (2) a declaration that sexual harassment is strictly prohibited; and (3) avenues of how to report claims of sexual harassment. Additional components of the policy that are recommended, and blessed by the U.S. Equal Employment Opportunity Commission (the federal agency tasked with enforcing Title VII of the Civil Rights Act of 1964 and other federal anti-discrimination laws), include the following:

- Anti-retaliation provision – Explicitly state that an employee reporting sexual harassment will not be retaliated against.
- Two avenues for reporting – In the event an employee feels his or her direct supervisor has engaged in harassing behavior, the policy should allow the employee to make a report

continued on pg 10

SEXUAL HARASSMENT POLICIES

continued from pg 9

of harassment to another individual. However, the individuals identified should be in management to ensure reports are properly and timely investigated.

- Investigation procedures – Outline that investigations will be completed promptly and on a case-by-case basis and identify what they may include or require.
- Confidentiality – Advise that confidentiality regarding any report of harassment cannot be guaranteed, but information regarding the report will be kept private to the extent doing so does not impede an investigation or violate applicable law.
- Disciplinary procedures – Forewarn about the consequences of engaging in sexually harassing behavior. It is recommended that employers do not develop stringent or rigid progressive discipline procedures, unless there is a reservation for the employer to terminate an employee immediately if the circumstances render such action appropriate.

Disseminate the Policy

Once an employer has established a sexual harassment policy, he or she is tasked with ensuring that all employees know about the policy. This is simple. First, the policy should be added to the employer's employee handbook. And, as with any new policy addition or refresh to an employee handbook, employees should be provided a copy of the policy, instructed to review the policy, and asked to execute a document acknowledging that they received, reviewed, and will comply with the policy. Then, the employer should periodically instruct managers to review the sexual harassment policy with their team on a bi-annual or more frequent basis. This step should be taken to heart because it would be a shame to have a well-established policy that your employees never knew existed. Plus, a failure to inform employees of your sexual harassment policy and procedures would exclude you from utilizing the Faragher/Ellerth affirmative defense. ■

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